federal register

Thursday
May 1, 1980

Part V

Department of Energy

Economic Regulatory Administration

Proposed Voluntary Guideline for the Automatic Adjustment Clauses Standard and Public Hearing

DEPARTMENT OF ENERGY

Economic Regulatory Administration

[Docket No. ERA-R-80-08]

Voluntary Guideline for the Automatic Adjustment Clauses Standard Under the Public Utility Regulatory Policies Act of 1978; Proposed Guideline and Public Hearing

AGENCY: Economic Regulatory Administration, Department of Energy.

ACTION: Notice of proposed voluntary guideline and public hearing.

SUMMARY: Title I of the Public Utility Regulatory Policies Act of 1978 (PURPA) established Federal purposes and policy standards for the regulation of electric utilities and imposes obligations upon State regulatory authorities and certain nonregulated utilities with respect to the standards established by sections 111 and 113.

Under section 131 of PURPA, the Secretary of Energy is authorized to prescribe voluntary guidelines respecting consideration of the standards. The appendix to this Notice is the proposed voluntary guideline for the automatic adjustment clauses standard established by section 113(b)(2) of PURPA. Written comments will be received and a public hearing will be held with respect to the proposed guideline.

DATES: Comment by 4:30 p.m., July 10, 1980. Requestes to speak by June 12, 1980, 4:30 p.m. Public Hearing on June 19, 1980, 9:30 a.m.

ADDRESSES: *All comments addressed to:* Department of Energy, Office of Public Hearings Management, Docket No. ERA-R-80-08, 2000 M Street, NW., Room 2313, Washington, D.C. 20461.

Requests to speak addressed to: Department of Energy, Office of Public Hearings Management, Docket No. ERA-R—80-08, 2000 M Street, NW., Room 2313, Washington, D.C. 20461.

Hearing location: Department of Energy, 2000 M Street, NW., Room 2105, Washington, D.C. 20461.

FOR FURTHER INFORMATION CONTACT:

Stephen S. Skjei, Division of Regulatory Assistance, Office of Utility Systems, Economic Regulatory Administration, Department of Energy, 2000 M Street, NW., Room 4016D, Washington, D.C. 20461, telephone (202) 653-3913.

William L. Webb, Office of Public Information, Economic Regulatory Administration, Department of Energy, 2000 M Street, NW., Room B-110, Washington, D.C. 20461, telephone (202) 653-4055.

Mary Ann Masterson, Office of the Gereral Counsel, Department of Energy, James Forrestal Building, Room 1E-254, Washington, D.C. 20585, telephone (202) 252-9516.

SUPPLEMENTARY INFORMATION:

I. Background

On November 8, 1978, the President signed into law the Public Utility Regulatory Policies Act of 1978 (PURPA), Pub. L. 95-617, 92 Stat. 3117 *et seq.* (16 U.S.C. 2601 *et seq.*) as one part of the National Energy Act.

Section 113(b)(2) of PURPA establishes a standard for automatic adjustment clauses. The standard, which must be considered by State regulatory authorities and certain nonregulated utilities in a manner specified by PURPA, defines an automatic adjustment clause as:

> A provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include an interim rate which takes effect subject to a later determination of the appropriate amount of the rate.

The standard provides that no electric utility may increase any rate pursuant to such clause unless the clause meets the requirements of PURPA section 115(e). Section 115(e) provides that an automatic adjustment clause must be determined at least every 4 years, by the State regulatory authority or nonregulated electric utility, after an evidentiary hearing, to provide incentives for efficient use of resources (including incentives for economical purchase and use of fuel and electric energy), and must be reviewed at least every 2 years, to insure the maximum economices in those operations and purchases which affect the rates to which the clause applies.

Section 115(e) is not intended by Congress to encourage or discourage the use of automatic adjustment clauses. In addition, this section is not meant to indicate a preference for the inclusion or exclusion of any particular item(s) in an automatic adjustment clause.

An automatic adjustment clause is a tariff provision, approved in advance by the regulatory body, whereby a price change in a preselected cost item or items will automatically permit a change in rates without formal regulatory hearings.

The purpose of an automatic adjustment clasue is to allow a utility to adjust its collection of revenue to compensate for changes in actual costs of a major expense item(s) over which it presumably has little or no control. The objective is to mitigate the effect of relatively volatile cost items which a utility purchases on a continual basis. A prime example in the case of electric utilities is fuel.

Automatic adjustmenmt mechanisms serve to recover or refund expenses pursuant to an approved formula without the necessity of a formal rate case, thus easing both financial and administrative burdens. In addition, the automatic adjustment clause can, in theory, mitigate risk and thus reduce the cost of capital to the utility.

Two requirements are generally inherent in automatic adjustment provisions. First, the expense for which automatic adjustment is allowed should be a relatively uncontrollable expense. Second, the expense should be variable with the volume of electricity sales; otherwise cost allocation is difficult and the adjustment cannot be made so as to recover for the utility precisely the increase (or decrease) which has occurred in operating costs.

The inclusion of fuel costs in adjustment clauses is intended to ensure the stability of utility earnings as fuel costs rise, while permitting rapid credits to consumers if fuel costs decline. Fuel costs are particularly significant because they account for a substantial percentage of the total cost of supplying electricity and have increased dramatically in recent years.

While fuel clauses are intended to protect a utility's earnings stability, they do not ensure that a utility's fuel purchase policies and practices are the most economical and efficient possible. In fact, fuel adjustment clauses in providing for automatic pass-through of certain costs, may permit, and even foster, inefficiency in fuel procurement practices and other utility management decisions. The automatic adjustment clauses standard established by PURPA is intended to address this situation by requiring regulatory authorities to build efficiency incentives into automatic adjustment clauses.

II. Alternative Approaches to the Automatic Adjustment Clauses Standard

In developing this guideline, DOE considered a number of approaches for providing incentives for efficient use of resources through the operation of an automatic adjustment clause. One possible form of incentive is to prohibit automatic adjustments altogether. While such a policy should motivate the utility to use resources efficiently and to purchase fuel and electric energy at the lowest evaluated cost, for most utilities it would imperil cash flow and thus the utility's ability to (a) provide needed maintenance on existing plants and

equipment, (b) provide reliable electric service, and (c) finance construction projects needed to meet increasing demands for electricity or displace existing oil- or gas-fired generation capacity. Accordingly, such an approach was rejected by DOE in developing the guideline. Instead, it focuses on the types of incentives which will comply with the intent of PURPA without impeding a utility's ability to cover its costs and provide service.

Ultimately, DOE identified two different approches. One approach is to provide incentives through regulatory review, including public scrutiny and in-depth staff analysis of utility procurement and resource use practices. A second approach is to provide incentives through the provisions of the clause itself by including financial rewards (or penalties) for the efficient (inefficient) use of resources. One of the most direct of such mechanisms is a fuel price index which allows automatic recovery of only those cost changes occasioned by changes in the prices paid by utilities for fuel.

A. *Periodic Review.* A public evidentiary review of those utility procurements and operations related to fuel, purchased power, and other costs recovered under an automatic adjustment clause should encourage utilities to use sound procurement practices and to operate and maintain their plant and equipment to assure maximum productivity. Such a review should include periodic audits of fuel and purchased power accounts, audits of procurement practices, and a detailed analysis of the utility's current level of powerplant productivity and planned future activities to improve productivity and reduce consumption of oil and natural gas.

A number of regulatory authorities have independent audits of accounting, utility operations and management practices under automatic adjustment clauses. This type of review should be combined with a procedure by which refunds to the consumers are ordered if inefficient or otherwise unwarranted activities occur. After-the-fact review has proven itself especially useful in connection with fuel procurement activities and regulatory oversight to ensure that fuel is acquired at the lowest evaluated cost.

DOE supports this approach to providing incentives for efficient resource utilization but argues that such audits be expanded to address the underlying rationale for fuel consumption patterns and opportunities for reducing reliance on scarce fuels. The effectiveness of after-the-fact review is highly dependent on the availability and careful analysis of relevant data, meaningful assessment criteria, and on the willingness of the regulatory authority to take appropriate corrective action when inefficiencies are identified.

B. *Price Index Adjustment.* A fuel price index clause provides incentives for a utility to use an economically efficient kilowatt-hour generation mix (weighted energy production by fuel type) by allowing for timely recovery only of those costs directly attributable to changes in fuel prices, and by delaying recovery (via a deferred fuel account) for variations in energy costs due to increased fuel use (e.g., an unacceptably high forced outage rate for efficient baseload units).

In a fuel price index, any adjustment allowed automatically in any time period would reflect changes in the prices of the fuels used, with each adjustment charge weighted in proportion to the role of the fuel in the base generation mix. The generation mix used to establish this price index would be fixed each time the fuel adjustment clause is reviewed in a general rate case (or in a periodic review process). The base generation mix used would include all costs of generation and transmission of purchased power, e.g., energy charges, adders and capacity charges. If the utility actually used a different generation mix than was embodied in the base period for its fuel adjustment procedure, the revenue excess or deficiency attributable to changes in the generation mix would be debited or credited to a deferred fuel account for subsequent review an amortization.

Such indexes were used in the 1950's and 1960's and automatically provide, without the need for subsequent regulatory action, incentives for utilities to keep their plant and equipment in sound operating condition. However, they may not provide, by themselves, needed incentives for sound fuel procurement practices. Further, they could lend to situations in which utilities are penalized, or rewarded, for events which are not, in fact, within their control.

Because of the complexities in designing and administering an effective price indexing system, DOE is not proposing such an approach in the guideline. However, comments on its design and implementation are specifically invited in order to privide DOE with current, accurate data on price indexing.

III. Guideline Issues

DOE is proposing that four major issues be addressed by State regulatory authorities or nonregulated electric utilities in designing an automatic adjustment clause. These include (a) incentives for effective fuel and purchased power procurement practices, (b) incentives for economic and efficient generation of electricity, (c) fuel adjustment charges incorporated into the rate structure, and (d) incentives for the displacement of oil and natural gas in the generation mix.

A. *Incentives for Effective Fuel and Purchased Power Procurement Practices.* DOE's review of existing automatic adjustment clauses found no generally acceptable method of providing incentives for effective fuel and purchased power procurement practices other than the regulatory authority's detailed review of the utility's planned and actual procurement practices. As stated above, permitting no fuel and purchased power cost increase pass through was rejected since it would tend to weaken the utility's financial ability to perform necessary maintenance, reliability, and construction programs. A planned delay in the recovery of all or part of the increased fuel expenses was also considered but was rejected since it would provide a needless penalty for those utilities which already have efficient procurement practices.

The guideline ties the regulatory authority's review of the utility's procurement practices to a potential refund to consumers if the utility's procurement practices for fuel and energy are determined to be inadequate.

Certain items set forth in the guideline should be included in the procedural review. Additional items, as necessary, may be added since the list is not intended to be inclusive. Special attention should be given to those cases where the utility purchases fuel or power from an affiliate or an interlocking directorate since arms-length negotiations as well as reasonableness of prices and costs must be ensured.

B. *Incentives for Economic and Efficient Generation of Electricity.* DOE believes that the most appropriate incentive for economic and efficient generation of electricity is provided by a regulatory authority's review of the utility's performance in achieving certain goals for economic and efficient generation of electricity. Factors to be considered by both the utility and the regulatory authority in setting such goals are included in the guideline. Although not proposed by DOE in the guideline, other methods of promoting generation efficiency, such as partial recovery of increased fuel costs not attributable to increases in fuel price, may be used along with the after-the-fact review.

DOE believes such a review is necessary for any automatic adjustment clause procedure. The guideline indicates that the continuation of an automatic adjustment clause should be made contingent upon the utility's avoiding abuses in its administration and, where appropriate, undertaking cost-effective programs for reducing utility consumption of scarce fuels.

C. *Fuel Adjustment Charges Incorporated Into the Rate Structure.* DOE believes that fuel costs should be incorporated into the rate structure in a manner which provides proper price signals to the consumer. Policies which fail to pass through unavoidable cost increases, or which impose substantial time lags, distort the proper price signals. The price of electricity should continuously reflect the economic cost of providing service to the maximum extent possible so as to provide the consumer with valid price signals on which to base his/her consumption decisions.

The guideline states that the basic rate structure should reflect marginal energy costs and that appropriate fuel cost surcharges should be properly allocated to the applicable time-of-use periods. The fuel charge in the basic rate structure and the surcharge imposed under an automatic adjustment clause should be time-differentiated to reflect the different prices of the mix of fuels used during onpeak and offpeak periods.

Any fuel or purchased power cost surcharges under an automatic adjustment clause should be small. As they become larger, adjustments to the basic rate structure are appropriate. In this regard, the use of zero-based fuel costs are discouraged in the guideline.

D. *Incentives for the Displacement of Oil and Natural Gas in the Generation Mix.* DOE believes that it is in the national interest to minimize the use of oil and natural gas for the generation of electricity. In accomplishing this objective many existing oil and gas-fired plants should be considered as potential candidates for conversion to, or replacement by, coal units. An automatic adjustment clause should be designed to facilitate rather than hinder such activity. In addition, the utility should periodically be required to establish that its projected system generation fuel mix is economically justified.

IV. The Proposed Guideline

As discussed above, two approaches which provide for efficiency and economy in the operation of automatic adjustment clauses are: (1) an adjustment clause which provides for periodic review of the utility's procurement operations and productivity improvement progress, and (2) a fuel price index which permits flow through of fuel price changes but places other fuel cost changes due solely to modifications in base generation mix into a deferred fuel account for subsequent review before recovery.

Both alternatives may provide incentives for efficient use of resources, as well as for increased economy in utility operations, while providing for timely recovery of costs that are not within the direct control of the utility. DOE believes that either alternative may permit the utility to recover legitimate and unavoidable fuel price increases while protecting the ratepayer from those increases that may result from poor management decision making.

It is DOE's conclusion that a careful procedural review of utility fuel procurement practices and generation operations, i.e., periodic audits, best serves to ensure incentives and economy where automatic adjustment clauses are used. Such a review requires establishing some criteria for determining whether utilities are operating efficiently. In the proposed guideline (see Appendix) DOE sets forth such a detailed procedural review as the preferred approach to satisfying PURPA section 115 requirements.

While comments are invited on all aspects of the proposal, comments are specifically requested on:

(1) The design of an automatic adjustment clause relative to time-varying rates;

(2) Emergency capacity and energy purchase pass-through provisions of an automatic adjustment clause;

(3) The use of an automatic adjustment clause to pass through a significant portion of profits on interchange sales;

(4) The use and administration of a deferred fuel account;

(5) Methods to encourage the replacement of oil and gas-fired generation with more abundant and economical fuels;

(6) The impact of an automatic adjustment clause design on energy conservation;

(7) The timing and scope of the utility auditing procedures;

(8) Methods of reflecting the marginal cost of fuel price signals in the automatic adjustment clause; and

(9) The criteria relevant to determining the efficiency of a utility's operation.

DOE also solicits comments, with respect to these items, on the fuel price indexing approach described above and the issues identified in Part III.

The guideline, when promulgated in final form, will be advisory in nature and not legally binding. It will, however, constitute DOE policy respecting consideration of the Federal standard for automatic adjustment clauses.

V. Written Comments and Public Hearing Procedures

A. Written Comments

The public is invited to participate in this proceeding by submitting to DOE's Economic Regulatory Administration (ERA) information, views or arguments with respect to the proposal set forth in the Appendix to this Notice. In addition, DOE welcomes comments on the fuel price indexing approach discussed in Part II above, as well as on any other approaches or issues pertinent to the automatic adjustment clauses standard. Comments should be submitted by 4:30 p.m. [70 days from date of publication], to the address indicated in the "ADDRESSES" section of this Notice and should be identified on the outside of the envelope and on documents submitted with the designation: "Proposed Voluntary Guideline on Automatic Adjustment Clauses, Docket No. ERA–R–80–08." Five copies should be submitted. All comments received will be available for public inspection in the DOE Reading Room, GA–152, James Forrestal Building, 1000 Independence Avenue, SW., Washington, D.C. 20585, and the ERA Office of Public Information, Room B–110, 2000 M Street, NW., Washington, D.C. 20461, between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday.

Pursuant to the provisions of 10 CFR 1004.11 (44 FR 1908, January 8, 1979), any person submitting information which he or she believes to be confidential and which may be exempt by law from public disclosure should submit one complete copy and five copies from which information claimed to be confidential has been deleted. In accordance with the procedures established at 10 CFR 1004.11, DOE shall make its own determination with regard to any claim that information submitted be exempt from public disclosure.

B. Public Hearing

(1) *Procedures for Request To Make Oral Presentation.* The time and place for the hearing are indicated in the "DATES" and "ADDRESSES" sections of this Notice. Any person who has an interest in this proposed guideline or represents a person, group or class of persons that has an interest, may make a written request for an opportunity to speak at the public hearing. Requests to speak must be sent to the address

shown in the "ADDRESSES" section and be received by June 12, 1980. The request should include a telephone number where the speaker may be contacted through the day before the hearing.

All persons participating in the hearing will be so notified on or before June 16, 1980. Speakers should submit 100 copies of their hearing testimony for distribution at the hearing by 4:30 p.m., June 18, 1980, to the Office of Public Hearings Management, U.S. Department of Energy, Room 2313, 2000 M Street, NW., Washington, D.C. 20461.

(2) *Conduct of the Hearing.* ERA reserves the right to schedule participants' presentations and to establish the procedures governing the conduct of the hearing. ERA may limit the length of each presentation based on the number of persons requesting to be heard. ERA encourages groups that have similar interests to choose one appropriate spokesperson qualified to represent the views of the group.

ERA will designate officials to preside at the hearing. These will not be judicial-type hearings. Questions may be asked only by those conducting the hearing. At the conclusion of all initial oral statements, each person who has made an oral statement will be given the opportunity, if time permits, to make a rebuttal statement. Rebuttal statements will be given in the order in which the initial statements were made and will be subject to time limitations.

Questions to be asked at the hearing should be submitted in writing to the presiding officer. The presiding officer will determine whether the question is relevant, and whether time limitations permit it to be presented for answer. The question will be asked of the witness by the presiding officer. The presiding officer will announce any further procedural rules needed for the proper conduct of the hearings.

ERA will have a transcript made of the hearing and will retain the entire record of the hearing, including the transcript. The record will be available for inspection at the DOE Freedom of Information Office, Room GA-152, James Forrestal Building, 1000 Independence Avenue, SW., Washington, D.C. 20585, and the ERA Office of Public Information, Room B-110, 2000 M Street, NW., Washington, D.C. 20461, between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday. A copy of the transcript may be purchased from the reporter.

(Public Utility Regulatory Policies Act of 1978, Pub. L. 950-617, 92 Stat. 3117 *et seq.* (16 U.S.C. 2601 *et seq.*); Department of Energy Organization Act, Pub. L. 95-91 (42 U.S.C. 7101 *et seq.*))

Issued in Washington, D.C. on April 24, 1980.

Hazel R. Rollins,

Administrator, Economic Regulatory Administration.

Appendix.—PURPA Guideline Number 3: Automatic Adjustment Clauses

A. *Introduction.* On November 8, 1978, the President signed into law the Public Utility Regulatory Policies Act of 1978 (PURPA), Pub. L. 95-617, 92 Stat. 3117 *et seq.* (16 U.S.C. 2601 *et seq.*) as one part of the National Energy Act.

Section 113(b)(2) of PURPA establishes a standard for automatic adjustment clauses for State regulatory authorities and certain nonregulated electric utilities. The standard provides that no electric utility may increase any rate pursuant to an automatic adjustment clause unless such clause meets the requirements set forth in PURPA section 115(e). Automatic adjustment clauses are tariff provisions that permit electric utilities to incorporate changes in selected costs—the most important and largest of which is fuel costs—into their rates without going through a full rate hearing. The adjustments to rates that occur under these clauses are intended to protect an electric utility's financial condition from large unavoidable cost changes which, because of their frequency, are difficult and costly for regulatory authorities to deal with in a timely manner.

Under section 115(e) of PURPA, an automatic adjustment clause is defined as:

> A provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include an interim rate which takes effect subject to later determination of the appropriate amount of the rate.

Section 115(e) further requires that an automatic adjustment clause must be determined, at least every 4 years, by the State regulatory authority or nonregulated electric utility, after an evidentiary hearing, to provide incentives for efficient use of resources (including incentives for economical purchase and use of fuel and electric energy), and must be reviewed at least every 2 years, to insure the maximum economies in those operations and purchases which affect the rates to which the clause applies.

Although the standard is primarily procedural in its orientation, it does clearly indicate that incentives for the economical purchase and use of fuel and electric energy should be part of any automatic adjustment clause. These incentives may be provided in a number of ways. They may be principally financial in nature, that is, an automatic adjustment clause may provide the utility with an inducement for the efficient use of fuel or the development of sound fuel procurement practices. Incentives may also be provided through regular public review and in-depth staff analysis of utility fuel procurement practices and use of generating resources.

In addition, incentives for the efficient use of resources may also emerge as a consequence of the rates charged for electricity. Electric utility rates based on marginal costs confront users with a price for electricity which more closely reflects the cost of the fuel used in its generation than rates based on average cost. If electric energy must compete with other sources of energy on its economic merits, through a system of marginal cost-based rates, utilities will have strong incentives to purchase and use fuels economically.

B. *Coverage.* This guideline covers the PURPA standard on automatic adjustment clauses and applies specifically to all automatic fuel adjustment clauses for covered electric utilities.

C. *Definitions.* As used in this guideline, except as otherwise specifically provided—

"Automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include an interim rate which takes effect subject to a later determination of the appropriate amount of the rate.

"Electric consumer" means any person, State agency or federal agency to which electric energy is sold other than for purposes of resale.

"Electric utility" means any person, State agency, or Federal agency which sells electric energy.

"Nonregulated electric utility" means any electric utility other than a State regulated electric utility.

"Rate" means (a) any price, rate, charge, or classification made, demanded, observed, or received with respect to sale of electric energy by an electric utility to an electric consumer, (b) any rule, regulation, or practice respecting any such rate, charge, or classification, and (c) any contract pertaining to the sale of electric energy to an electric consumer.

"Rate schedule" means the designation of the rates which an electric utility charges for electric energy.

"State agency" means a state, political subdivision thereof, and any agency or instrumentality of either.

"State regulatory authority" means any State agency which has ratemaking authority with respect to the sale of electric energy by any electric utility (other than such State agency), and in the case of an electric utility with respect to which the Tennessee Valley Authority has rate making authority, such term means the Tennessee Valley Authority.

D. *DOE Guidance.* Incentives which are established by regulators must be carefully designed. They can promote the efficient use of resources, but they can also place a utility in a position where its continued ability to provide reliable service to its customers is jeopardized. Extreme financial disincentives can seriously imperil a utility's cash flow and thus its ability:

(a) To provide needed maintenance on its existing plants and equipment:

(b) To continue to provide reliable electric service; and

(c) To finance construction projects needed to meet increasing demands for electricity or displace existing oil or gas fired generating capacity.

For these reasons, in designing for incorporation into an automatic adjustment clause, it is important to consider whether the incentives would tend to impede a utility's ability to provide service.

This guideline is organized around four major issues which State regulatory authorities and nonregulated utilities should address in their consideration of the automatic adjustment clauses standard to determine if a utility is achieving the highest levels of economy and efficiency in fuel procurement and system operations. These include:

(1) Provision of Incentives for Effective Fuel and Purchased Power Procurement Practices;

(2) Provision of Incentives for Economic and Efficient Generation of Electricity;

(3) Incorportion of Fuel Adjustment Charges Into the Rate Structure.

(4) Provision of Incentives for the Displacement of Oil and Natural Gas in the Generation Mix.

Each of these issues is discussed below.

(1) Incentives for Effective Procurement Practices. Incentives for effective procurement practices are most appropriately provided by a periodic review of fuel purchases with potential refunds for costs deemed to have been unjustifiably incurred. With respect to economic purchase of fuel, standardized methods for measuring management effectiveness are not readily available. Whether a utility has used sound procurement practices in purchasing fuels is best determined on a case-by-case basis, with appropriate opportunities for public participation.

Procedural review of management activities and procurement practices can be especially effective when tied to a potential refund obligation of unjustified expenses. The utility should carry the burden of showing that its reported policies and practices are economical and efficient. The review process should include, but not be limited to, the following items:

(a) An account audit of fuel (and purchased power) transactions to:

(i) Determine if the fuel associated costs (handling, etc.) are properly identified and recorded in the appropriate Uniform System of Accounts (Accounts 151, 501, 518, etc.). Included in this determination should be a review of the current treatment of nuclear fuel costs (handling, storage and disposal costs, depreciation, etc.), a review of invoices, and a review of discount dates;

(ii) Determine if purchased power and associated costs included therein are properly identified. Assure that purchases displacing higher cost self generation are distinguished from purchases made for other reasons;

(iii) Determine if the accounting treatment of interchange transactions is proper; and

(iv) Determine if opportunities for profitable sales of interchange capacity and energy are being aggressively pursued.

(b) A management audit of the utility's current procurement practices including such practices as delegation of responsibility for procurement (organization), capacity to address both near and long-term requirements (current planning), updating procurement plans and monitoring (plan execution), and allowance and treatment of specific accounts within the fuel adjustment clause and fuel source bids (soliciting); also included in this audit would be a review of fuel quality and quality control, sizing of fuel stock levels, contract price measured against reasonably available alternatives, taking into account relevant terms and conditions and regional market prices, and any variations from contract terms.

(c) An analysis of a utility's plans to improve procurement procedures and measure quality of procurement operations (develop an effective planning and decision model for achieving lowest evaluated long-term fuel prices and periodic independent review of procedures under (a) and (b) above).

Scrutiny of automatic adjustment factors by the regulatory authority should cover an additional item where either fuel or purchased power is obtainable from an affiliate or through an interlocking directorate. The existence of such a relationship may necessitate reviewing transactions to insure arms-length negotiations as well as reasonableness of prices or costs passed through to the utility's customers. The Federal Energy Regulatory Commission (FERC) has some authority and responsibility in this area; however, utility systems operation and planning (which affect utility rates) occur at a regional level. As such, it is the responsibility of the State regulatory authority to determine the reasonableness of costs ultimately to be paid by ratepayers within its jurisdiction.

(2) Incentives for Economic and Efficient Generation of Electricity. The economical use of fuel should be assessed, where possible, by how efficiently a utility operates its baseload plants; by the capacity and availability factors of these plants, and, where relevant, by the heat rates of these plants. In addition, opportunities for improving fuel economy through engineering modifications to plants should also be identified and established.

Useful data on capacity and availability factors achieved from nuclear generating units are available from the Nuclear Regulatory Commission. Similar data for coal plants are available from the Office of Utility Systems, Economic Regulatory Administration, DOE, and the National Electric Reliability Council. These data can be used as reference points by both the utility and the regulatory authority for determining general levels of efficiency for baseload plants and for designing programs for productivity improvements.

The utility's avoiding abuses in the administration of the fuel adjustment clause and, where appropriate, undertaking cost-effective programs for reducing consumption of scarce fuels should be made a review criterion for continuation or approval of an automatic adjustment clause. This review of a utility's performance should address the following:

(a) Availability and capacity factors of baseload generation units,

(b) Utility's forecast for improved availability and proposals to achieve higher levels of performance,

(c) Progesss made previously in improving capacity factors,

(d) Identification of needed capital improvements,

(e) Plans for effective preventive and outage maintenance of baseload generation units,

(f) Capital and operating cost increases necessary to achieve improved productivity from baseload units,

(g) Demonstrated current activity to obtain cost-effective power transactions,

(h) Specific plans for decreased use of scarce fuels,

(i) Analysis of fuel cost implications of meeting environmental standards, e.g., low sulfur coal versus high sulfur coal with scrubbers based on minimum present worth of life cycle revenue requirements,

(j) Demonstrations that purchased power displaced higher cost self-generation, particularly that using scarce fuels, as a condition of recovering the total cost of such purchases, and

(k) Demonstrations that power purchases, for reasons other than displacement of higher cost self-generation, were prudent and justified as a condition of recovering the excess of the total cost of such purchases over the fuel cost component.

Reliance on after-the-fact reviews places a burden on the regulatory authority to determine whether a utility is fully identifying and exploiting cost-effective opportunities for increasing the performance of baseload generation. In addition, regulatory authorities will also need to be able to differentiate between situations in which an unplanned outage is due to events beyond the utility's control and those in which it is not. Authorities will likely have to increase their expertise in the area of powerplant performance and maintenance in order to determine the level of expenditures which is in the best interest of utility customers.

(3) Incorporation of Fuel Adjustment Charges Into the Rate Structure. The economical use of electric power by end-users can be affected by the way base period fuel costs are incorporated into rate structures. Fuel adjustment charges should be incorporated into rate structures in such a manner as to least distort the incentives for conservation.

Automatic adjustment clauses have generally been designed to track changes in average fuel costs because, like rates in general, they must conform to a revenue requirement based on average total costs. However, rates provide the best incentives for end-use efficiency (conservation) and for efficient use of utility resources when they reflect marginal costs rather than average costs. Special attention must, therefore, be given to the way in which fuel adjustment surcharges affect the rate structure of an electric utility, to ensure that fuel adjustments do not unnecessarily distort incentives for energy conservation that have been incorporated into that rate structure.

The maintenance of appropriate onpeak/offpeak price differential where time-varying rates are in effect is a specific problem that arises in this regard. The problem is likely to be greatest where the onpeak rate reflects the costs of oil-fired generation and the offpeak rate does not. If oil prices increase more rapidly than the prices for coal or nuclear fuel, then the onpeak/offpeak rate differential should widen. The challenge is to develop a fuel adjustment procedure that comes as close as possible to capturing the proper differentials in both fuel prices and generation mix used in different time periods.

Automatic adjustment surcharges should be small; the basic rate structure should be readjusted when fuel cost changes become large. Rate structures with zero-based fuel costs, where the entire fuel expense is covered in the adjustment surcharge, are generally inappropriate and misleading to the consumer.

(4) *Incentives for Displacement of Scarce Fossil Fuels in the Generation Mix.* By allowing a utility to pass through fuel price increases automatically, automatic adjustment clauses reduce incentives for replacement of oil and gas-fired capacity with new coal or nuclear capacity. Utility decisions to invest in new generation sources which use alternative fuels and which displace uneconomic uses of oil and gas can reduce the total revenues (and present value of life-cycle revenue requirements) collected from utility customers over the operating life of a new plant using coal, nuclear, or renewable energy resources.

Automatic adjustment clauses directly limit the timing and level of recovery of fuel costs and can bias decisions involving the replacement of oil and gas in the generation mix with coal and nuclear. The large capital costs of new baseload powerplants may result in cash flow problems even with adjustment clauses that permit complete recovery of all fuel expenses. Where automatic adjustment clauses contain financial penalties, they may impede a utility's ability to undertake construction programs which would replace scarce fossil fuels with coal, nuclear, or renewable resources in the generation mix. Conversely, automatic flowthrough of fuel costs may also dissuade utilities from investing in capital intensive generating capacity. In the consideration of the standard, the impact of any clause on a utility's ability and incentive to implement a system generation plan which minimizes total generation costs over time should receive careful analysis, including periodic reviews of system expansion plans, to establish that the long-term system fuel mix is economically justified.

[FR Doc. 80-13436 Filed 4-30-80; 8:45 am]
BILLING CODE 6450-02-M